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A Compilation of Accounting Title Studies

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A COMPILATION OF ACCOUNTING TOPIC STUDIES

by
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Approved by

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ABSTRACT

WILLIAM DOSSETT: A Compilation of Accounting Topic Studies

(Under the direction of Dr. Victoria Dickinson)

The purpose of this paper is to investigate a broad range of accounting topics and issues that are areas of complexity in the accounting profession. Through the course of a year in the independent study course, our class, led by Doctor Dickinson, delved into these topics to further our understanding of them. Each case covered a different topic, and, concerning the matter that we researched, we produced a report. Pertaining to each report, please consult the school archives for the Honors Accounting class for any necessary materials. After completing this thesis, our class has developed an understanding for these accounting issues that perplex professionals today, has learned how to research these issues effectively with materials we have at our disposal, and has applied our knowledge to real-world cases to constitute an elite learning experience as accounting majors in the Sally McDonnell Barksdale Honors College.

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Glenwood Heating, Inc. and Eads Heaters, Inc.
September 9, 2015

Head to head, Glenwood Heating, Inc. outperforms Eads Heaters, Inc. through analysis of ratio tests of liquidity, profitability, and long-term solvency ratios. In retrospect, Glenwood is the company to invest in and Eads is due for a reevaluation from their management!

Glenwood's current ratio and acid test is 4.8 and 2.98, respectively, meaning that it can more easily pay its bills than Eads, with 1.3 and .87. Cash, because of its liquidity, is essential for any business and, without plenty on hand, it cannot function. How profitable is a company with great accounts receivables but cannot pay its workers salaries or its own overhead? Glenwood could pay off its current liabilities more easily than Eads according to the ratios of liquidity.

In regards to profitability, Glenwood again has the upper hand with a profit margin of .23 to Eads .18 and a return on owners equity of .4 to Eads' .34. The higher profit margin for Glenwood shows their higher efficiency and limit on expenses, turning greater profits from their sales than does Eads. Its superior ROE indicates Glenwood's profitability per dollar the shareholder invests. Investing equal capital, Glenwood's Earnings per share of 28.9 to Eads 22.0 shows that Glenwood generates higher earnings per each invested dollar.

Glenwood's higher profitability has not been generated more recklessly than Eads, either. Although Eads debt ratio of .71 and Glenwood's .64 are both high, Glenwood's percentage of assets provided through debt is less. A higher debt ratio makes it harder for a company to borrow money as well.

Reviewing and analyzing the ratios, Glenwood is in better position to succeed.

Glenwood Heating, Inc.
Financial Ratios
For the Year Ended Dec. 31, 20XX

Liquid Ratios	
current ratio	1.316144
acid-test ratio	0.878188
a/r turnover	4.220057
days to collect receivables	86.491719
inventory turnover	3.701961
days to sell inventory	98.596398
operating cycle	158.088117
Profitability Ratios	
gross profit margin	0.526223
profit margins	0.176951
return on assets	0.100197
return on owners equity	0.340135
earnings per share	22.035938
Long-Term Solvency Ratio	
debt ratio	0.70542
times interest earned	-0.009283

Glenwood Heating, Inc.
Statement of Cash Flows
For the Year ended Dec. 31, 20XX

Cash flows from operating activities	
Net Income	70515
Adjustments to reconcile net income to net cash proided by operating activities	
Depreciation expense	41500
increase in a/r	-94430
increase in inv	-51000
Inc in A/P	26440
Inc in int payable	6650
Net cash provided by op activities	-325
Cash Flows from investing activities	
purchase of equipment	80000

purchase of land	70000
purchase of buildings	350000
<u>Net cash provided by investing activities</u>	-500000
<u>Cash flows from financing activities</u>	
Payment of cash dividends	23200
issuance of common stock	160000
lease payable	83360
redemption of bonds	380000
<u>net cash provided by financing activities</u>	-159840
net increase in cash	-660165

Eads Heaters, Inc.	**Classified Balance Sheet** As of Dec. 31, 20XX			
Assets			**Liabilities & Stockholders' Equity**	
Current Assets			**Current Liabilities**	
Cash	7835		A/P	26440
			Interest Payable	6650
A/R	99400		Lease Payable	83360
Less: All for B.D.	-4970		**Total Current liabilites**	116450
Inventory	51000			
			Long Term Debt	
			Twenty-year 7% debenture due Sept. 30, 20XX	380000
Total Current Assets	153265		**Total liabilities**	496450

Property, Plant, Eqt			**Equity**	
Land	70000		C/S	160000
Buildings	350000		Retained earnings	47315
Less: acc dep	-10000		**Total Equity**	207315
Eqt	80000			
less: acc dep	-20000			
leased Eqt	92000			
less: acc dep	-11500			
Total P,P,E	550500			
Total Assets	703765		**Total liabilities and stockholders' equity**	703765

Eads Heaters, Inc.
Statement ofRetained Earnings
For Year ended Dec. 31, 20XX

	Total
Beg Retained Earnings: Jan 1,	0
Net Income	70515
less: dividends	23200
Ending Retained Earnings: Dec 31	47315

Glenwood Heating, Inc.
Financial Ratios
For the Year Ended Dec. 31, 20XX

Liquid Ratios	
current ratio	4.884618
acid-test ratio	2.986763
a/r turnover	4.04955

days to collect receivables	90.133476
inventory turnover	2.818471
days to sell inventory	129.502825
operating cycle	219.6363
<u>Profitability Ratios</u>	
gross profit margin	0.555834
profit margins	0.232728
return on assets	0.144316
return on owners equity	0.404031
earnings per share	28.981875
<u>Long-Term Solvency Ratio</u>	
debt ratio	0.64281
times interest earned	-0.592188

Glenwood Heating, Inc.
Statement of Cash Flows
For the Year ended Dec. 31, 20XX

Cash flows from operating activities	
Net Income	92742
Adjustments to rec…	
Dep Exp	19000
Inc in A/R	98406
Inc in Inv	62800
Inc in A/P	26440
Inc in Int Pay	6650
Net cash provided by op activities	16374
Cash flows from investing activities	
Purch of Equipment	80000
Purch of Land	70000
Purch of Building	350000
Net cash provided by financing activities	500000
Cash flows from financing activities	
Payment of Cash Dividends	23200
Issuance of C/S	160000
Redemption of Bonds	380000
net cash provided by financing activities	243200

net increase in cash	759574

Glenwood Heating, Inc.
Classified Balance Sheet
As of Dec. 31, 20XX

Assets		**Liabilities and Stockholders' Equity**	
Current Assets		Current Liabilities	
Cash	426	A/P	26440
		Interest payable	6650
A/R	99400	Lease Payable	0
Less: All for D.A.	994	**Total Current liabilites**	33090
Inventory	62800		
		Long Term Debt	
		Twenty-year 7% debenture due Sept. 30, 20XX	380000
Total Current Assets	161632	**Total liabilities**	413090
Property, Plant, Eqt		**Equity**	
Land	70,000		
Buildings	350,000	C/S	160000
less: acc dep	-10000	Retained Earnings	69542
Eqt	80000		
Less: acc dep	-9000	**Total Equity**	229542
Total P,P,E	481000		
Total Assets	642632	**Total liabilities and stockholders' equity**	642632

Glenwood Heating, Inc.
Statement of Retained Earnings
For Year ended Dec. 31, 20XX

Retained Earnings: Jan 1	0
Add: Net Income	92742

Less: Dividends	23200
Retained Earnings: December 31	69542

Glenwood Heating, Inc.
Multistep Income Statement
For the Year Ended December 31, 20XX

Sales Revenue	398500
Cost of Goods Sold	177000
Gross Profit	221500
Selling and Admin Expense	70194
Income from Operations	151306
Interest Expense	27650
Income before taxes	123656
Income Tax	30914
Net Income	92742

Glenwood, Inc, Financial Information

	Cash	A/R	Allowance for Bad	Inventory
A1	160000			
A2	400,000			
a3	-420,000			
a4	-80,000			
a5				239800
a6		398500		
a7	299,100	-299100		
a8	-213,360			
a9	-41,000			
a10	-34,200			
a11	-23,200			
a12				
totals	47340	99400	0	0
Part B				
B1			994	
B2				-177000
b3				
b4	-16000			
B5	-30919			
TOTAL	426	99400	994	62800

Land	Building	Acc Dep, Bldg	Eqt	Acc Dep, Eqt	Leased Eqt	Acc Dep, leased Eqt
70,000	350,000					
			80,000			
70,000	350,000	0	80000	0	0	0
		10,000		90000		
70300	350000	10000	80000	9000	0	0

A/P	I/P	N/P	Lease/P
		400,000	
239800			
-213360			
		-20000	
	6650		
26440	6650	380000	0
26440	6650	380000	0

C/S	R/E	Div	Sales	CGS	Bad Debt Exp	Dep Exp	Int Exp	Op exp	Rent Exp
160000									
			398500						
							21000		
								34200	
		23200							
							6650		
160000	0	23200	398500	0	0	0	27650	34,200	0
					994				
				177,000					
						19000			
									16000
160000	0	23200	398500	177000	994	19000	27650	34200	1600

Provision for Income Taxes
0
34914
34914

Eads, Financial Information

	Cash	A/R	Allowance for Bad Debts	Inventory	Land	Building
A1	160000					
A2	400,000					
A3	-420,000				70,000	350,000
A4	-80,000					
A5				239800		
A6		398500				
A7	299,100	-299100				
A8	-213,360					
A9	-41,000					
A10	-34,200					
A11	-23,200					
A12						
totals	47340	99400	0	239800	70,000	350,000
	Cash	A/R	Allow for Bad Debts			
B1			4970			
B2				-188800		
B3						
B4	-16000					
B5	-23500					
Totals	7840	99400	4870	51,000	70000	350000

Acc Dep, Bldg	Eqt	Acc Dep, Eqt	Leased Eqt	Acc Dep, leased Eqt	A/P	I/P	N/P	Lease/P	C/S
									160000
							400,000		
	80,000								
					239800				
					-213360				
							-20000		
						6650			
0	80000	0	0	0	26440	6650	380000	0	160000
10,000		20,000							
			92000	11,500				83360	
10,000	80000	20000	92000	11500	26440	6650	380000	83360	160000

R/E	Div	Sales	CGS	Bad Debt Exp	Dep Exp	Int Exp	Op exp	Rent Exp	Provision for Income Taxes
		398500							
						21000			
							34200		
	23200								
						6650			
0	23200	398500	0	0	0	27650	34,200	0	0
				4970					
			188000						
					30000				
					11500	7360			
									23505
0	23200	398500	188000	4970	41500	35010	34200	0	23505

CASE 2: RETURN ON NET OPERATING ASSETS
Molson Coors Brewing Company
September 23, 2015

A. The major classifications on an income statement are Sales, Gross Profit, Expenses (controllable, operating, and fixed), and Profit/Loss.

B. A classified income statement organizes financial information to provide investors with data to easily evaluate company profitability and other financial metrics. A classified income statement provides Gross Margin (revenues less cost of goods sold), Operating Expenses (in order to find Gross Profit from Operations) and Non-Operating Expenses (interest and taxes).

C. Persistent income statement accounts are accounts that continue from one year to the next. Financial statement users might be interested in a measure of persistent income in order to measure the most regular actions of the company, those that make up the most comprehensive measure of a company's actions, being that they are ongoing.

D. Comprehensive income is a broader measure than net income. It included items like unrealized holding gains/losses on available-for-sale securities, certain pension adjustments, and certain foreign currency translation gains/losses.

E. Molson Coors Brewing Company's income statements report both sales and net sales because Net Sales are Sales after the Excise taxes imposed on the sale of, in this case, alcohol. They may show these items separately in order to correctly represent their total sales and to disclose the amount of tax imposed on their product.

F.

a. The types of items that comprise Special Items include unusual items, impairments, restructuring charges, or fees on termination of significant operating agreements and gains/losses on disposal of investments. The types of items that Molson Coors includes in Special Items are most commonly impairments of intangible assets and restructuring, specifically largely in European and Canadian office.

b. Special items are included on a separate line item than other expenses so that the company can demonstrate the irregularity and unpredictability of these expenses, while they still are relevant to the production. These are separately reported to provide the user with proper comparability in financial statement year-to-year metrics.

G. Other Income Expenses are classified primarily as gains and losses associated with activities not directly related to brewing and selling beer, as in the case of Coors. An example is that certain gains or losses on foreign exchange and on sales of non-operating assets are classified in this line item. Special Items are charges incurred or benefits realized that are not believed to be indicative of core operations. The difference between these two classifications is that Special Items are not core operations, are very infrequent, and rarely happen.

a. Comprehensive income for 2013 is 765.4 million. The net income for 2013 is 572.5 million. Net income is lower, because all the other comprehensive income accounts have bypassed the income statement because they are not realized, such as unrealized gains/losses from the sale of securities and the foreign currency translation. As well as pensions and other postretirement benefits. These items that affect net income and lead you to comprehensive income.

b. On the Comprehensive Income statements, the accounts that affect it are unrealized accounts such as gains/losses from unrealized securities; other retirement plans (gains/losses), foreign currency transaction adjustments, and other unrealized items. These accounts related to comprehensive income can help foreshadow what might happen to the performance of company down the road.

H. Accounts on MC's income statement that are considered non-persistent are those considered "Special Items" and, in this case, "Net Income Loss/Gain for discontinued operations" and "other income expense, net." Special Items will not necessarily recur, being irregular and unpredictable and nature. Loss/Gain for discontinued operations naturally will be non-persistent since it will soon terminate.

I. Coors effective tax rate in 2013 is Income Tax Expense/Pretax Income à 84 Million/654.5 Million = 12.83% or approximately 13% Effective Tax Rate.

a. A tax rate for MC that domestic operations will continue to be taxed at the combined statutory rate that prevailed in 2013 would be around 13% because of the lower effective income tax rate applicable to the foreign domestic. The effective tax rate in 2011 was 13%. In 2012 the effective tax rate spiked to 26% and it was only because the effect of foreign law and rate changes spiked for just one year. Another spike in 2012 was the change in valuation allowance. If these were back to normal, like they are in 2011 and 2013, then the effective tax rate that would persist for Coors would be 13%.

J. When calculating our estimate of persistent income for MC we took out the recurring items such as Income from discontinued operations, Special items, and Other income (expense) net. When calculating the estimate we got a new income of 918.5 million.

K.

a. The following items on the financial statements are considered "nonoperating" in the income statement: Special Items, Other income (expense), and Income from discontinued operations.

b. The tax on Special Items, which is 200 million, is 24 million. The Special Items is a loss on the financial statements. Other income (expense) net, has a total balance of 151.2 million, when taxed at 12% it has a taxed amount of 18.14 million. The final item is a loss from discontinued operations. The loss was taxed for a tax benefit of $624,000. Considering that all these items decrease the net income, the taxed amount decreases the loss on the items. The total after-tax amount, after deducting the taxes (12%) is 313.636 million.

c. The net operating profit can be found in different ways according to the basis of net income. For MC, we assume the income is from various places outside of domestic business. We do not specifically know the tax rates in each place of business MC has performed, so to understand a greater estimate for the net operating profit we tax net income by the effective tax rate. This is done because the effective tax rate is the total for all of the different taxes MC has incurred. The net income of 567.3 million is taxed at 13% (effective tax rate) giving us a taxable amount of 73.749 million. Giving us a net operating profit of 493.551 million for 2013. For 2012, the net income of 443.0 million is taxed at 13%, giving a taxable amount of 57.59 million. Therefore our net operating profit is 385.41 million for 2012

L.

a. Assets that we consider nonoperating include Cash and equivalents, Goodwill, trade, Notes receivable, investments, affiliates, and other assets. Cash is considered operating and nonoperating in the sense that it can be part of the on-going operations of a business. Goodwill is not an operating asset because it is related to the purchase of an asset above market value. An asset that is contributing to the day-to-day operations needs to be at the least tangible in the operations. Investments can potentially generate revenues, but that's not always the case in the day-to-day operations. All of the other assets come down to the basis of These are all of the items on the assets that do not contribute to day to day operations.

   Liabilities that are considered nonoperating are Derivative hedging instruments, Discontinued operations, other liabilities, and Pension and postretirement benefits. A derivative hedging instrument is used for interest rate contracts. This has no appeal to the normal business operations. Discontinued operations is discontinued, so therefore it is not a benefit to the on-going daily operations. Pensions and postretirement benefits are given out after the business operations are complete.

   (ii) For the year 2013, we calculated the net operating assets to equal $2966.2 (in millions). For 2012, we calculated them to be $2768.1.

   N. MC's Return on Net Operating Assets for 2012 was 13.92%, and MC's return for 2013 was 16.64%. 2013's return on 16.64% indicates better operating profit performance, utilizing the operating assets at hand.

   O. Computing the operating profit margin, you divide revenues by operating profit.. For 2013 the operating profit margin is 11.73%. The operating profit margin for 2012 is 9.84%. The net operating asset turnover is calculated by revenues divided by net total assets. The 2013 turnover is 1.4180 times of turnover. The 2012 turnover is 1.4149 times.

   P. Instead of using the net operating profit, we used persistent income which we calculated it to be 918.5 million in 2013 and 798.2 million for 2012. The adjusted RNOA for 2013 is 30.97%. The new adjusted RNOA for 2012 is 30.88%. The persistent income showed a better predictor for the future profitability.

Summary and suggestion to buy

I would recommend investing in Molson Coors', as the multinational corporation has many foreign interests, benefits of foreign business incentives like low effective taxes, no fraud or misplaced funds, as does Volkswagen now, and is relatively stable through the Financial Statements that we are presented between 2011 and 2013.

The theme of my study has emphasized the use of distinguishing between the daily, recurring functions of the corporations monetary flow and the nonrecurring, nonoperating monetary flows through the company; especially important is the different effects that including or excluding these two different classes of distinguishing items in Financial Statements. Using the Net Return on Operating Assets, Operating Profit Margin, and Net Operating Asset Turnover Ratios and equations, we emphasize the similarities between the corporation's years. This is very important because without these operating equations, and instead incorporating many different Extraordinary items, Special items, and gains/losses from discontinued operations, etc., into the numbers to indicate the effect of seldom, unusual events, the corporation's years could have vastly different numbers despite Operating Profit margin being very similar and many of the day to day functions unchanged between years.

For example, In December 2012, MC made about 161.9 million dollars less in Comprehensive income than they did in 2013. At first glance, an investor would imagine that the company is doing vastly better, recovering from a bad year, or is very volatile and thus unattractive to invest in. Largely this difference in income is due to a loss on derivative instruments in 2012. Despite volatile income numbers, the corporation did not make any fundamental errors in business.

In regards to operating expenses, MC's Net Operating Asset Turnover ratio between 2012 and 2013 was 1.4149 and 1.4180, respectively. Return Net on Operating Assets was 13.92% and 16.64% respectively in 2012 and '13. Based on operating performance, MC is very stable. A very good investment in an economy influenced by fluctuating markets and command economies, such as China.

The use of Persistent Income in this study made for better predictions of the future. The unusual events that may have made 2012 look worse were eliminated. Using Persistent income in RNOA, we got 30.88% and 30.97%, which shows very good return on future investments in this corporation.

Strong buy.

CASE 3: STATEMENT OF CASH FLOWS
Golden Enterprises, Inc.
October 7, 2015

A. The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of an enterprise during a period. It reports the effects of operations during a period, investing transactions, financing transactions, and the net increase or decrease in cash during the period. To investors and creditors, it tells where the cash came from during the period, what it was used for, and what was the change in the cash balance during the period. Importantly to external users, it shows if cash from operations exceeds cash from selling assets or from borrowed funds, which is an indicator of how sustainable a company is.
B. The two different methods of preparing the statement of cash flows are the indirect and direct methods. Golden Enterprises uses the indirect method because it starts with net income and makes adjustments to convert it to a cash basis. Most companies prepare their statement of cash flows using the indirect method because the accrual basis of accounting provides a better measure of the movements of cash in a company, disclosing all revenues earned and expenses incurred in a period.
C. The three sections of a statement of cash flows is operating, investing, and financing.
D. The operating section relates to the balance sheet because it accounts for the more liquid, current assets and liabilities that add or subtract from it cash flows. The investing section pertains to the noncurrent assets of the balance sheet, specifically the Property, Plant, and Equipment section, and it accounts for the increase or decrease in these assets in relation to the company's cash flows. The financing section of the cash flows relates to the equity section and long-term liabilities of the balance sheet.
E. Cash equivalents are liquid investments that mature within three months or less.
F. Net income is the first item on the statement of cash flows, despite the fact that the accrual basis is used. This is so that the net income can be reconciled to recognize revenues and note expenses when they were incurred. The purpose is the accrue all cash flows from the net income to a net increase or decrease in cash for the company over a period.
G. Statement of Cash Flows

	A	B	C	D
1	**Golden Enterprises, Inc.**			
2	**Statement of Cash Flows**			
3	**For Year Ended Dec. 31, 2013**			
4				
5	**Operating Activities**			
6	Net Income		$1,134,037	
7	Adjustments to reconcile net income			
8	to net cash provided by op. activities			
9	Depreciation Expense	3,538,740		
10	Deferred Income Taxes	-185,939		
11	Gain on sale of Property and eqt.	-61,040		
12	Decrease in A/R	106367		
13	Decrease in Inventory	200985		
14	Decrease in Prepaid Expense	200137		
15	Change in surrender value of ins.	62906		
16	Increase in other assets	-191298		
17	Decrease in A/P	-1,216,399		
18	Increase in Accrued Expense	954938		
19	Change in Salary cont. plan	-49774		
20	Decrease in Accrued Income Taxes	113,369		
21	Net Cash provided by op. activities		$4,607,029	
22				
23				
24	**Investing Activities**			
25	Purchase of Property,Plant, Eqt	-4,149,678		
26	Proceeds from sale	74514		
27	Net Cash used in Investing		-4,075,164	
28				
29	**Financing Activities**			
30	Debt Proceeds	38,361,199		
31	Debt Repayment	-38,287,529		
32	Checks outstanding in excess of bank balance	-267501		
33	Purchase of Treasury stock	-6,860		
34	Cash Dividends payment	-1,467,879		
35	Net Cash provided by financing activities		-1,668,570	
36				
37	Net decrease in cash		-1,136,705	
38	Beginning Balance	1,893,816		
39	Closing Balance for the end of the year	$757,111		
40				

Here is inscribed the statement of cash flows for Golden Enterprises, Inc. We used the Indirect Method to prepare this financial statement, meaning that we took Net Income and made adjustments to reflect the inflows and outflows of the company's cash, and convert it to a cash basis. We broke the statement up into operating, investing, and financing sections to more accurately appropriate the cash flows into their respective categories. In making calculations, characteristically of the statement of cash flows, we added back depreciation and amortization, deducted increases and added decreases in relevant current assets, added increases and deducted decreases in relevant current liabilities, and added back loses/deducted gains.

We do this because, for example, an increase in A/R may increase net income, but that amount increase of A/R is deducted away from net income under operating activities because it is not a cash flow. Likewise, while a gain in sale of equipment increases net income, it is deducted under investing activities because it does not add cash to the total cash balance.

H. Depreciation and amortization are added back to net income in the operating section of the statement of cash flows, not because they actually generate cash for Golden Enterprises, but because it is taken off the books as a cash expense. It is taken into account from a capital depreciating. Since its expense does not involve cash, it is put back onto the books so that the company's cash flows is not influenced by the accounting for the company's fixed, noncurrent assets.

I. Golden Enterprises' profitability and ability to generate cash can be measured by looking at the Cash Debt Coverage, the Profit Margin, and the Return on Assets. Golden Enterprises' poor ability to cover their debts with cash is shown with their less-than-average Cash Debt Coverage ratio of 38%, where good is considered higher towards 1. Their Free Cash flow equation shows that they have negative cash due to the high amount they repaid in dividends and their high capital expenditures. Their Profitability is very unimpressive, measured by a 2012 profit margin of 1.6% decreasing to .8% in 2013. Their Return on Assets is weak as well, only 2.4% is 2013 after being still low, but higher, 4.5% in 2012.

J. Golden Enterprises has decreased its productive capacity over the years because its net cash provided by operating activities has decreased, specifically 5,747,290 in 2012 to 4,607,029 in 2013. This has caused an overall decrease in cash flows.

K. If Golden Enterprises decides to increase spending on capital expenditures from 4,075,164 in 2013 to 5,000,000 in 2014, it must have a substantial benefit to the Return on Assets that allows the company to pay off this significant expenditure and resulting debt. It has a resulting debt because the addition approximate $900,000 deducted from cash flows would be greater than the 757,111 beginning cash balance. Therefore, it lacks the capacity to make such expenditures and should be discouraged. In order to make such additional expenditures, the company will need to either issue new stock for capital or to borrow money through bonds.

CASE 4: ACCOUNTS RECEIVABLE
Pearson
November 2, 2015

A. Receivables are claims held against customers and others for money, goods, or services. For financial statement purposes, companies classify receivables as either current (short-term) or noncurrent (long-term). Accounts receivables are oral promises of the purchaser to pay for goods and services sold. Account receivables may have referred to as invoice, balance due, debt, receivable, or bill, depending who is calling it a receivable.
B. Accounts receivable differ from notes receivable in that they are oral promises of the purchaser to pay for goods or services, where notes receivable are written promissory note to pay a certain sum of money on a specified future date. Notes receivable may have a stated rate of interest, and they are always reported at the present value of the cash they expect to collect.
C. A contra account is an asset account that has a normal credit balance but is paired with an asset account that it offsets. The contra asset accounts associated with Pearson's trade receivables include net of provisions for bad and doubtful debts and anticipated future sales returns.
a. The types of activities captured in the contra assets "provision for bad or doubtful debts," which is the same as the account "allowance for doubtful accounts," include the company preparing for a certain, good faith estimated percentage or number of receivables that customers will not paying. This is why it is the contra asset paired with receivables, and Managers use historical data and their customer's habits to decide on their good faith value for the contra asset.
b. Anticipated future sales returns is the contra assets for net sales revenue. It is the activity for expecting how much of the company's sales account will be returned and credited from the sales account. Managers find it by analyzing historical data in the sales returns and allowance accounts as well as analyzing the possibility that the products are faulty. If this estimate is not made or made high enough, then sales will be overstated.
D. The percentage-of-sales procedure and the aging-of-accounts procedure are used for estimating uncollectible accounts receivable, also known as allowance for doubtful accounts. Percentage-of-sales procedure is more from an income statement approach and uses past experience and anticipated credit policy to find the "percentage" used with sales; the managers multiply this designated percentage by the sales, in dollars, to account for the bad debt expense for the item for the current period. The total bad debt expense will accumulate in the credit account allowance for doubtful accounts. The aging-of-sales procedure starts with company's managers setting up an aging schedule of accounts receivable, which applies a different percentage based on past experience to the various age categories. An aging schedule also identifies which accounts require special attention by indicating the extent to which certain accounts are past due. It results in a more accurate estimate of net accounts receivable because each section of the schedule's receivables is evaluated more accurately according to its specific qualities.
E. Pearson anticipates that some accounts will be uncollectible and still extends credit to these customers because there is no way of knowing which customers will default on

their debt but, instead, it is a fact of selling on credit to have some customers unable or unwilling to pay. Reasons for customers defaulting on their debts include them going to jail, dying, or bankrupt. Managers consider risk in accounts receivable as a necessary evil ever present in society and often may use secured borrowing to have collateral for uncollected receivables, with the legal system to enforce these notes.

F.

a. The line items that reconcile the change in the account that states trade receivables at fair value, net of provisions for bad and doubtful debts and the movements involved in it between the income and balance statements. At the beginning of the year is the value for the total bad debt expense. In 2009 there is 72 million pounds at the beginning year, which is also the end of the 2008 period whose beginning balance was 52. For exchange differences, the next line item, there was a debit of 5 (+ number as noted in footnote), which indicates that 5 million pounds were debited from provisions for bad and doubtful debts because the exchange rate gain. Income statement movements credit 26 in 2009, meaning that allowance for doubtful accounts credited and increased 26 million pounds because those "movements" are the actual computation of bad debt expense and the movement of that from sales to the balance sheet. Write offs on the account is known as utilized in British English, and the debit of 20 decreases the provisions account, which is a contra-asset, normal credit balance, shows that 20 million pounds were recorded as a loss and utilized. Next, through business combination, there was 3 million pounds recorded as a credit to provisions to bad debt expense. At the end of 2009, there was a credit balance of 76 million pounds in provisions for bad and doubtful debts.

b. 9/09 Bad and Doubtful Debts Expense (I/S) 26,000,000
Provisions for Bad and Doubtful Debts (B/S)
26,000,000
10/09 Provisions for Bad and Doubtful Debts (B/S) 20,000,000
Trade Receivables (B/S)
20,000,000

c. The provision for bad and doubtful debts expense is included in the income statement under operating expenses.

Provision of Sales Returns

425	
	71
354	

This is a provisions of sales returns account, which is a contra-revenue account that offsets the sales account. Of the 425 amount estimated to be returned in 2009, only 354 were actually returned; therefore, 71 million pounds were credited and put back on the books in order to not understate sales and overstate returns.

12/1/09

Provision for sales returns (B/S)	425	
Trade receivables (B/S)		425
Estimated sales returns of 2009		

12/31/09

Trade receivables (B/S)	71	
Provisions for sales returns (B/S)		71
Reconcile for overstated Provisions for Sales Returns		

ii. In 2009, the company took the estimated sales returns by calculating that 25 percent of trade receivables would be returned. (.25 x 1419=354)

Provision for sales returns (B/S)	354	
Trade receivables (B/S)		354
To account for estimated sales returns.		

iii. The estimated sales returns appears included into the Sales line item of the income statement.

H.

Gross Trade Receivables '08

1091	
4811	430
	27
	3971

1474	

Gross Trade Receivables '09

1474	
5624	444
	20
	5215
1419	

Above are T-accounts for the gross trade receivables for 2008 and 2009. This account shows the relative similarities for 2009's provision for bad and doubtful debts, 72, and provision for sales returns, 372, totaled on the account as 444 and 2008's 430 (76 and 354) million pounds. This likely shows no change in credit policy or customer base. As for the cash collections (3971 and 5215 for '08 and '09), the two years collected cash from a relatively similar percentage of their beginning and current year receivables, 67% of 2008's and 73% of 2009. The likely increase in received cash in 2009 is due to the higher number accounted for sales returns and provision for doubtful accounts and the fact that the 2009 account began with 383 million pounds more on the books than in 2008, representing an older number of accounts receivables due.

Credit Sales	5624
Inventory	5180
Provisions for sales returns	444

To record sales on account

Cash 5215
Trade receivables 5225
To record accounts receivable collection activity

I. According to my calculations, for 2009, by their estimated % uncollectible trade receivables, the company would not collect 74.19 million pounds of their gross trade receivables. An auditor must report the error that the company reported 76 million pounds to not be received. Falsely reporting a higher provision for bad debts is a common way to reduce the taxable base for income and therefore increase net income.

	Trade Receivables balance	Estimated % uncollectible	Accounts esti uncollectible
Within due date	1096	2%	21.92
Up to three months past due date	228	4%	9.12
Three to six months past due date	51	25%	12.75
Six to nine months past due date	20	50%	10
Nine to 12 months past due date	4	60%	2.4
More than 12 months past due date	20	90%	18
Total	1419		74.19

	2009	2008%
Credit Sales, net	5624	4811
Average gross trade receivables	1446.5	1282.5
Accounts receivables turnover	3.89	3.75
Average collection period	93.83	97.33

J. In 2008, there were much less credit sales than in 2009, and, of those sales, a higher percentage of them were trade receivables; therefore, it was slightly more difficult for the company to collect their receivables in 2008 than in 2009. I noticed this information because the accounts receivables turnover in 2008 opposed to 2009 was 3.75 to 3.89, showing that the company in 2009 collected their receivables faster than in 2008. By 2009's higher average collection period in days of accounts receivable of 93.83 to 2008's 97.33, we read that it took the company about four less days in 2009 to collect their receivables, fairly likely due to their lower percentage of trade receivables per total sales than the previous year. Most importantly to note, Note 22 shows that 2008 had more old receivables various stages past due than did 2009. It is much more difficult to collect these old receivables than new.

K. In 2009, McGraw Hill Publishing had average collection period in days of 79.0 compared to Pearson's 93.8. This shows that McGraw Hill was considerably faster and more efficient at collecting their receivables per year, and Pearson has several policies that it should implement in order to align more with that of its peer. Ways to increase their accounts receivable turnover rate and their average collection period include first adjusting their payment policy to pay the company's payables after the company receives the customer's receivables. This means for the company tightening the credit policy on accounts receivables so where the company does not receive them after they have to pay their bills. Having more receivables on the books by demanding the customers pay sooner accounts for much better cash flows and higher rates of receivable turnover. Secondly, the company could incentivize the customers to pay their bills sooner by offering discounts to them for paying within a certain period. This is a common practice for companies who want their receivables turned over sooner.

CASE 5: U.S. GAAP
Graphic Apparel Corporation
November 4, 2015

1. GAC is changing this year their financing method, for they are going from equity financing to debt financing. This means that instead of acquiring capital through issuing common stock, GAC now will finance their property, plant, or equipment through taking on debt. Additionally, Nicki altered the style of GAC's graphic shirts, garnering respect from new critics but causing her to lose her old base of retailers, who cut their orders back.
   a. Nicki owns GAC, since she bought from the former owner's shares. Changing GAC from equity financing to debt financing, Nicki now owns the company in entirety, limiting ability for anyone else to buy stocks of the company. The exchanged the company buys using a leveraged management buyout, where the management of a company purchases the company through getting a loan secured by the company's assets.
   b. Nicki's bank uses the financial statements to determine how the company is doing in regards to the lending standards. Furthermore, the IRS is an external user that requires financial statements from the company.
   c. GAC's new business relationship with the bank is very important because the bank has agreed with Nicki to fund GAC's debt and finance the operations and investments of the business.
2. The big events to account for in 2014 are the winter purchasing of plain white and black T-shirt batches from suppliers, the spring accounting of the cost of graphic T-shirt production, the sales in early summer to retail clothing stores, the October 15th returns, and the sales to these batches discounted to stores. Otherwise, Nicki is to account for many transactions between GAC and retail stores.
   a. The custom shirts business is going well. We know this by comparing GAC's sales order this year, totaling $10,000, to last years, which totaled on $100.
   b. We know that GAC's customer base changed from conservative styled retailers to new start-up companies excited to offer these graphic designs. Also, a large group of Nicki's customer base includes local community sports teams and organizations seeking custom orders, of whom she personally had connections.
   c. In the end, the new graphic works out well because it catered to a new and equally as large group of people who better fit Nicki's style, who we assume are equally as reliable. Net revenues were about the same in regards to selling batches of graphic designed shirts this year for GAC in the income statement, despite changing graphics.
   d. This year, the warehouse had a leak in the roof. It was repaired with little cost, but the leak damaged some of the raw materials inventory of plain, un-inked shirts. Instead of recording the damages as a loss, Nicki used the damaged inventory as a unique style.
3. The revenue principle, also known as the revenue recognition principle, reports that you should only record revenue when it is earned, which complies with GAAP.
4. GAC reports its revenue from custom orders before she produces the items. These are simply revenues. Recording revenues is appropriate not in GAC's case, because it violates the revenue recognition principle. The case in which recording the revenue is appropriate only when services are matched with revenues, as suggested by GAAP.
5. Alternative to reporting custom orders as revenue received before receipt, an accountant should report as point in time on financial statements in reception of a custom order the revenue once it is actually earned and the custom product in the customers hands. This would result in compliance with the revenue recognition principle suggested by GAAP.

6. The best method for recognizing revenue from custom orders is receiving and recording the cash from the custom T-shirt customers as unearned revenue then producing them. Primarily, showing unearned revenue shows more accurately the mandate that the company must produce the shirts before they really earn the sale. Supporters of this method also would argue that it benefits the company to have the cash on hand to cover the costs of goods sold as well as insuring a higher net realizable value.
7. If GAC changed this method from recording revenue first as earned to instead recording the unearned revenue, the income statement would have much less sales revenue. GAC's current ratio would be affected negatively, since the movement of revenue, an asset, to unearned revenue, a liability would decrease the current ratio.
8. GAAP requires that accounts receivable be reported at their net realizable value when the sales transaction takes place. This means that as soon as the customer takes ownership of the goods (and the seller removes the items from inventory and records cost of goods sold) the seller should records sales and create the account receivable. The entire receivables account should only reflect the total amount of receivables the company expects to receive in cash.
9. GAC uses the direct write-off method to account for bad debts. This method is not allowed under GAAP (except in extremely rare circumstances) as it neither reports receivables at their net realizable value nor does it comply with the matching principle.
10. Since GAC now must report its financial statements, in accordance with GAAP, they must change to using the allowance method. This method achieves expense recognition and lists receivables at their net realizable value by estimating bad debts each period and then adjusting this number at the end of each period. Instead of writing off unrealized accounts against receivables as GAC currently does, under the allowance method GAC will now write off bad debts against the allowance account. This prevents the write-off of individual bad debts from affecting net income and complies with the standards set by GAAP for reporting receivables at their net realizable value. (doesn't answer second question)
11. Instead of using the direct write-off method for uncollectible accounts, as GAC uses currently, the company could switch to the allowance method for uncollectible accounts. The direct write-off method is better in some ways, because it is much more simple and less costly to implement. Additionally, it does not need to make any estimates, but rather it records the bad debt expense when they know that they will not be collected.
12. GAC should switch its method of valuing receivables to the allowance method for uncollectible accounts. The direct write-off method is not considered appropriate when there are considerable amounts of uncollectibles because it fails to record expenses in the same period as the revenues (complying with the matching principles we live by in accounting) and it does not state receivables at net realizable values on the balance sheet. The allowance method does record at net realizable values on the balance sheet because it takes an estimate and records an expense based on that estimate of receivables that will not be paid from the customer. This expense gives us a relevant and timely measure of our current bad debts.
13. This method would affect the balance sheet because under the direct write-off method there is not contra-asset account as there is in the allowance method that deducts the amount of receivables that are probably not going to be collected. Under the allowance method, there is an allowance for doubtful accounts recorded under the receivables as a

contra-asset. Additionally, the bad debt expense, that is recorded simultaneously with the allowance for doubtful accounts, is recorded on the periods income statement as an expense. Therefore, under the allowance method, the current assets will be stated rightfully less than that of GAC's current balance sheet's current assets. Additionally, GAC's current income statement will be record a higher net income than had they used the allowance method because the allowance method records an expense to compensate for the future uncollectibles.

14. GAC reports sales returns on August 31, or year end, on the income statement for the graphic shirts but does not allow returns on custom sales. The return on graphic design shirts is only permissible if the return is made before October 15 of the year they were recorded first as accounts receivable by GAC. This method is acceptable when the amount returned each year is immaterial, or very minute in the grand scheme of the business; therefore, this method of recording the returns only when they are returned is acceptable for GAC to use.
15. This year in 2014, circumstances are slightly different because there was very much damage to a large amount of graphic shirts. Nicki fixed these shirts as best as she could, but they were still described as "gritty." Therefore, when the shirts were on sale in the retail store, they did not sell well and were replaced by different products. Therefore, by year end, these shirts may be returned depending on the contract between GAC and the retailer.
16. Under these circumstances, when returns are expected to be substantial, or "material," GAAP suggests that the sales returns and allowances be recorded in advance to actually receiving the returns, as a contra-liability account that subtracts from sales revenue, each year at year end, using calculations of returns as a percentage of sales.
17. GAC should consider using the percent of sales method because, while not material today, returns are likely to be material in the long run, especially now that GAC is using new companies and exploring new, untested products.
18. The method most appropriate for accounting for sales returns is in turn allotting a percentage of sales towards the sales returns and allowance account because GAC, at this rate of growth and with Nicki's vision of expansion, eventually will have a material amount of returns, and they will be forced later to implement this policy anyway.
19. Currently, if GAC changed to accounting for returns in this alternate method, then their income statement will be slightly understated as well as the balance sheet. This is because there will be more returns recorded than there are now. It is still important to implement this policy now so that financial statements are consistent in the future.
20. GAAP suggests inventory to be recorded at lower-of-cost-or-market.
21. GAC has been reporting its inventory at lower-of-cost-or-market, calculating cost with the weighted average cost flow assumption. This method is appropriate in cases where the inventory can all be sold despite the time it is purchased. Inventory price can be averaged in the case of this clothing company because it is not aging or becoming obsolete in the market.
22. This year the inventory sat on retailers shelves much longer, and for this reason GAC should use the method called "retail inventory method."
23. There is evidence to suggest that GAC will be forced to mark down its inventory below cost because, according to their balance sheet, inventory has grown more proportionately than other related line items, like net income and cost of goods sold, representing a lack

of ability to sell in some areas, such as the store that moved the discounted graphic shirts off the racks in replace of a new stores inventory.

24. GAC should report its inventory applying the retail inventory method. This method converts the inventory valued at retail to approximate cost by applying the cost-to-retail ratio.
25. This method would lower ending inventory's cost from where it is currently to make it a proportion of the retail costs. It would be much more accurate this way. More accurate it is, the current ratio would be smaller because there would be less inventory on the books.
26. With inventory at 50% in 2014 of $12250 instead of $24,500, the current ratio would be $48,500, total current asset, divided by total current liabilities, $45,180. The ratio would be 1.07. These changes being made, with the hypothetical cost-to-retail ratio, would go from 1.35 in 2014 to 1.07 in the same year.
27. To return the current ratio to one, if the current ratio were below 1.0 at, say, .5, then there would need to be additional equity of $22,590 to return the ratio to 1.
28. Nicki should use the Net Realizable Value when valuing inventories. This is a controlled market with a quoted price applicable to all quantities, and the cost figures required for a cost-to-retail system are too hard to attain for a part time accountant and an owner who does not have accounting experience.

CASE 6: DEPRECIATION
Planes and Garbage
November 18, 2015

Part I

1. Completed the following table after analysis of 2004 annual reports of Northwest Airlines, Delta Airlines, and United Airlines:

	Northwest	Delta	United
Book Value January 1, 2005	$75,000,000	$75,000,000	$75,000,000
Residual	3,750,000	3,750,000	3,750,000
Depreciable amount	71,250,000	71,250,000	71,250,000
Useful life (years)	14.5	20	27.5
Annual Depreciation	4,913,793	3,562,500	2,590,000
Accumulated Depreciation at December 31, 2008	19,655,172	14,250,000	10,363,636
Book Value at December 31, 2008	55,544,828	60,750,000	64,636,364
Sales Price I	55,000,000	60,000,000	65,000,000
Gain (-Loss) on Sale I	-544,828	-750,000	-363,636
Sale Price II	60,000,000	60,000,000	60,000,000
Gain (-Loss) on Sale II	$4,655,172	-750,000	-4,636,636

2. Why would these three companies depreciate the same equipment using different useful lives? Describe at least two possible explanations.

a. These three companies may have depreciated the same equipment using different useful lives if they had:

i. Different past experiences with similar assets.

ii. Sophisticated empirical methods used to calculate the amount of years the equipment would be used.

iii. Variations of the expected mileage.

3. Which set of sale prices (I or II) do you think is more realistic? Why?

a. Sale I is more realistic because each airline used their equipment at different frequencies and sustained different amounts of damage and repairs. Therefore, they should be sold at different sales prices.

Part II: Garbage Trucks

1. From at least 1992 through part of 1997, the directors of Waste Management inflated their earnings by improperly deferring or eliminating current period expenses. In addition, Waste Management made a series of many other malpractices including failing to record expenses in the decreases of value of filled and expended landfills, wrongly capitalizing a variety of expenses, and failing to establish sufficient reserves to pay for income taxes and other expenses.

2. Management deferred or eliminated current period expenses by, without explanation, increasing the salvage value of their trucks and by extending the useful lives of these trucks to spread out depreciation.

3. The managers of Waste Management wanted to manage earnings in order to manipulate the financial statements released to the public. These inflated quarterly and annually earning statements influenced greatly WMI stock prices. Additionally, after

achieving their fraudulent target earnings, the managers rewarded themselves with large, performance-based bonuses.

4. Arthur Andersen was Waste Management, Inc.'s external auditor during WMI's fraudulent financial reporting habits and failed to publically report WMI's fraud, among other things.

Consistently, AA knowingly issued unqualified audit reports. AA did assign to WMI multiple times Proposed Adjusted Journal Entries to correct their past financial mistakes, but WMI failed to make these correcting adjustments in order to sustain their false earnings level. Afterwards, AA secretly entered an agreement with WMI to allow them to write off their accumulated expenditures, especially the deferred depreciation expenses, in order to correct old wrongs over the future. In this agreement, AA wrote a Summary of Action Steps report acknowledging the fraud the WMI for so long committed.

Arthur Andersen was charged by the SEC for knowingly committing fraud of overstating $1 billion of WMI's earnings in "improper professional conduct" and settled for $7 million in civil penalty, censorship compliance with the SEC, and various degrees of punishment for the several partners.

Andersen agreed to these settlements without confirming or denying them.

CASE 7: CONTINGENCY FORMATTING
Construct and BigMix, Inc.
December 10, 2015

For of the following answers, sourcing has been sited through the website https://asc.fasb.org/home for U.S. GAAP codification and through http://www.iasplus.com/en for IFRS codification.

Question 1: In 2007, at the time of the purchase, should Construct record a liability for environmental liabilities? If so, how much?

Construct should not record a liability for environmental liabilities for, at that time, the environmental liability was not both probable and reasonably estimable, and, therefore, should not be reported according to codification 410-30-25-1 of U.S. GAAP. This codification states that a liability will be accrued if information, available before the financial statements are issued, indicates that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. No estimates were given to provide reason to record liability.

Additionally, according to IAS 37.14, an entity must recognize a provision if, and only if, the payment is "more likely than not" and the amount can be estimated reliably. Therefore, the provision for potential environmental liabilities should not be recorded in Construct's financial statements.

Question 2: In 2008, should the company record any liability due to BigMix filing for Chapter 11? If so, how much?

Construct should not record liability because there is no measurable amount mentioned, as needed according to IAS 37.40, and needed in order to record by these IFRS principle-based codifications.

As for U.S. GAAP, again, codification 410-30-25-1 specifies that there need not be a record here of any liability due to the lack of reliability of estimation.

Question 3: In 2009, should the company record any liability for the potential environmental liability? If so, how much?

In U.S. GAAP, there is percentage used often among American companies to determine whether a company's contingency is probable or not and that number is subjectively between 70-80%. The loss contingency is reasonably estimated at $250,000, but, since the probability is only 60% that the loss will be incurred, then we will not record this liability under U.S. GAAP rules.

Applying the IFRS standard, the requirements to record this loss contingency are met because the loss is reasonably estimated, and it is probable that Construct will incur the contamination penalty. According to IFRS, probability must be simply "more likely than not" when determining whether or not to record in the financial statements. Using IFRS, Construct will record a liability for the potential environmental liability.

Question 4: In 2010, should the company record any liability for the potential environmental remediation? If so, how much?

By GAAP rules as well as IFRS standards, Construct needs to record legal fees related to administering the remediation action of $100,000 and total estimated amount of $300,000 because they are clearly estimated well and, because of BigMix bankrupt position, it is probable that Construct will be incurring these unilateral legal fees on their own financials.

Question 5: In 2011, should the company record any additional liability for the potential environmental remediation?

Codifications 410-30-30-7 and 410-30-30-8 state that Construct should have an allocable share of the liability for a specific site and a share of amounts related to the site that will not be paid by other potentially responsible parties or the government in order to record the amount of $1.5 million dollars. The $1.5 million cost of the recommended remediation plan is reasonably estimable and probable that Construct will pay a portion, but 100% of it is a rare option and would severely overstate financial statement expenses and liabilities. This number, since it is a government agency's mandate as stressed in 410-30-30-11, should be disclosed and not recorded by GAAP rules.

Question 6: In 2012, should the company record any gain contingency/contingent asset for the potential settlement?

By GAAP rules citing codification 450-30-25-1, a contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization. Although it is probable that Construct will obtain $1million in settlement with BigMix's former shareholders, doing so would go against the principle of conservatism in financial reporting.

Complying with GAAP rules, according to the IFRS standards of codification IAS 37.31-35, contingent assets should be disclosed in this situation and not recognized because the inflow of economic benefits is only probable. Only when the realization is virtually certain, then can the asset be recognized as appropriate.

CASE 8: LONG-TERM DEBTS
Rite Aid Corporation
February 3, 2016

A)

i. Secured debt is backed by a pledge of some sort of collateral while unsecured debt has no collateral put up. Rite Aid has to distinguish between the two of these because the secured debt can be recovered in the event of default while unsecured cannot. The unsecured debt has certain restrictions around its existence package, but those may only be restrictions on accumulation of cash instead of a nominal appraisal of collateral.

ii. If debt is guaranteed then it means that a "parent" company has signed off on the debt to assume debt obligation if the borrower is unable to pay. Rite Aid acts as the company who guarantees the debt of its subsidiaries.

iii. The term senior pertains to debt that must be paid off before the other types of debt if the company goes bankrupt. Fixed rate bonds avoid the risk of having a fluctuating interest rate and guarantees that the borrower does not have to pay more interest expense than stated for either the term of the loan or at least part of the loan. Convertible debt can be converted into another type of security such as common stock.

iv. Each interest rate is specific to the type of debt that it is for. These interest rates are determined using information that is on hand at the time that the debt is issued. The different types of debt have differing terms and will be paid off at different times, as well as unique riskiness that directly factors into the interest rate decision. For this reason each debt is independent of the next, thus calling for a different interest rate.

B)

Rite Aid has 6,370,899 dollars of total debt at February 27, 2010, in note 11. Of this, only 51,502 dollars is currently maturing, meaning it will be paid for within a fiscal year. This means that the rest of the debt comes from long-term debt, less current maturities and lease financing obligations, less current maturities. Therefore, note 11's total debt is composed of two types of long term debt plus the currently maturing portions of this debt. Of the Balance Sheet as of February 27, 2010, the sum of the line items 'current maturities of long-term debt and lease financing obligations,' 'long-term debt, less current liabilities,' and 'lease financing obligations, less current maturities' equals that 6,370,899 dollars of total debt in note 11.

C)

i. The face value of these notes is 500,000 dollars. We know this because there is no mention of a discount or a premium with this note. From 2009 to 2010, the carrying value of the note stays the same. This means that the carrying value is equal to the face value and it is, therefore, not at a discount or a premium.

ii.	Cash	500,000	
	Notes Payable		500,000
iii.	Interest Expense	37,500	
	Cash		37500

iv. Notes Payable 500,000
Cash 500,000

D)

i. The face value is 410,000 dollars. The carrying value is 405,951 dollars. This means that the remaining unamortized discount is 4,049 dollars. As the discount is amortized, the carrying value will increase to 410,000 dollars by the time. There is a discount in this note because the coupon rate is less than that of the effective rate.

ii. Noting a difference between the total amount of interest expense on the year and the amount actually paid, Rite Aid expensed $38,437.50, for this was the coupon rate of .09375 multiplied by the face value of the bond, $410,000.00.

iii. Rite Aid would have paid for these 9.375% notes $41,087.11 because that would have been the beginning of the period carrying value of the bonds multiplied by the market rate, as used to calculate the periodic interest expense under the effective interest method.

iv. Interest Expense $41,087.11
Cash $38,437.50
Bond Disc. $2,649.61

v. (515,763)/(5,801,230+169,796)= 8.64% total interest rate

E)

i. 6/30 Cash $402,620.00
Bond Discount $7,380.00
Bonds Payable $410,00.00

ii. The effective annual interest rate when the notes were issued was 10.1212%.

iii.

Date	Int. Pmt.	Int. Exp.	Bond Disc. Amort.	Net Bk Value, Debt	Eff. Int. Rate
6/30/09	--	--	--	$402,620	10.12%
6/30/10	$39,975	$40,749.98	$774.98	403,394.98	10.12%
6/30/11	$39,975	40,828.42	853.41	404,248.39	10.12%
6/30/12	$39,975	40,909.34	934.34	405,182.73	10.12%
6/30/13	$39,975	40,004.49	1029.49	406,212.22	10.12%
6/30/14	$39,975	40,108.68	1133.68	407,345.90	10.12%
6/30/15	$39,975	40,223.40	1248.4	408,594.30	10.12%
6/30/16	$39,975	40,349.74	1374.74	410,000	10.12%

iv. 2/27/10 Interest Expense 20,374.99

iv. 2/27/10	Interest Expense	20,374.99	
	Bond Discount		387.49
	Interest Payable		19,987.50

v. The net book value of the note following this entry would be $403,821.69 because the amortized discount from the half-year would add $426.71 to 403,394.98.

vi.

Date	Int. Pmt.	Int. Exp.	Bond Disc. Amort.	Net Bk Value, Debt	Eff. Int. Rate
6/30/09	--	--	--	$402,620	9.75%
6/30/10	$39,975	$41,029.29	$1,054.29	403,674.29	9.75%
6/30/11	$39,975	$41,029.29	$1,054.29	404,728.58	9.75%
6/30/12	$39,975	$41,029.29	$1,054.29	405,782.58	9.75%
6/30/13	$39,975	$41,029.29	$1,054.29	406,837.16	9.75%
6/30/14	$39,975	$41,029.29	$1,054.29	407,891.45	9.75%
6/30/15	$39,975	$41,029.29	$1,054.29	408,945.74	9.75%
6/30/16	$39,975	$41,029.29	$1,054.29	410,000	9.75%

Rite Aid does report the same interest rate on these notes each year because this is the way employed in the straight-line method.

vii. Comparing the year-by-year difference in interest expense derived from each method, we note that in the effective interest method of e. iii. yields a lower interest expense at first and gradually surpasses the interest expense in the later years of the note's term. Where the straight-line method yields constant bond discount amortization and interest expense, the effective interest rate method's amortization and interest expense both start off less that its correlate and finishes higher.

All things considered, the difference is not material in this case. On June 30, 2011, for example, Rite Aid would report under their straight-line method only $200.00 more than under the effective interest method; however, a company as large as Rite Aid has many outstanding long-term debts and the accumulation of this is material. Also, employing one tactic or the other effects the company for tax purposes, worth noting.

F)

i. Notes Payable		801,519	
	Cash		797,769
	Gain on Redemption of Bonds		3,750

ii. Any company extinguishing debt before its maturity date only pays the net carrying amount of the bonds adjusted for unamortized premium or discount, and cost of issuance. Any excess of the net carrying amount over the reacquisition price is a gain from extinguishment.

iii. The market rate of interest at the time of the repurchase was higher than the 9.5% coupon rate, resulting in the bond discount sold with the bond. On the other hand, it is lower than the effective rate because the discount declined in amount.

G)

Firms issue convertible notes because they don't have to back them with securities—the bonds can be converted into common stock of the issuer firm. They allow for the company to attract capital easier in a tight money market since they offer ownership as well as simply interest as incentive to any buyer.

If these notes were converted into common stock from their current place as a long term debt, Rite Aid's balance sheet would lose long-term liabilities the nominal amount of the 8.5% convertible notes; and equity would rise through an increase in common stock at that same, fair value nominal amount of the former note.

H)

i.

Ratio	Industry Average	Rite Aid FY2009	Rite Aid FY2008
Common-size debt	43.83%	120.79%	114.41%
Common-size interst expense	0.35%	2.01%	1.82%
Debt to assets	14.41%	78.50%	71.71%
Long-term debt to equity	.26x	3.776x	4.9773x
Proportion of LTD due in 1 year	6.11%	0.81%	0.68%
Times-interest-earned	33.44x	.0695x	(4.33)x

ii. Rite Aid compares to the industry very negatively. Most startling is its debt to asset ratio, which shows consistently about 500% higher than the industry average. This represents an amount of long-term debt on Rite Aid's balance sheet in relation to its total assets, which shows that it is unsustainable and dangerous for the firm. Common-size debt is about three times that of the industry average, which represents the amount of total liabilities to the total assets. This represents an increasing difficulty and inability to pay off these future financial obligations.

iii. As Rite Aid's debt percentages increasingly numerically overwhelm the numbers, representing worse solvency, leverage and more standing financial burdens, analysts like myself reach the conclusion that Rite Aid will not be able to meet its long term commitments.

I)

I used reference to Rite Aid's ratios that I calculated with numbers from the end of fiscal 2009 to compare Rite Aid's financial situation with others of the industry. With the help of the Standard and Poor's scale and the information listed above in part h, I was able to determine that Rite Aid should receive a BBB- credit score.

Several factors influenced my decision to award Rite Aid this score. First, it is important to remember Rite Aid's large and prosperous business model; they filled 300 million prescriptions in 2009, accounting for about 68% of their sales. They rank 3rd largest among pharmaceutical companies in the U.S. Therefore, business is so good for them in the current economy that they are able to sustain an aggressive debt model and break away from the careful debt ratio maintenance smaller companies would need.

Still, Rite Aid has a concerning amount of long-term debt in relation to its total assets, as demonstrated by the debt to asset ratio. Here, in 2009, the industry average has 14.41% while Rite Aid operates with 78.5%. This raises eyebrows because these long-term liabilities really need to be paid off with assets and, with this ratio, it would be an increasingly difficult task and higher financial risk.

Because of these concerns, Rite Aid receives the score of BBB-, considering the lowest investment grade by market participants. This is because there is an adequate capacity to meet financial commitments, demonstrated by Rite Aid's past, their massive amounts of cash flow, and their successful business model; however, because they are so locked up with their financial burden and their high level of debt to asset, if adverse economics occur in the future then this corporation could face serious collapse.

CASE 9: COMMON STOCK
Merck & Co., Inc. and GlaxoSmithKline plc
February 17, 2016

A)

i. 5,400,000

ii. 2,983,408,675

iii. .01 cent

iv. 811,005,791

v. 2,172,502,884

vi. 2,172,502,884*57.61=$125,157,900,000

B)

i. 10,000,000,000

ii. 6,012,587,026

iii. 5,373,862,962

iv. 504,194,158

v. Share capital is the funds that an entity raises in exchange for issuing owners equity in the form of shares. On Merck & Co., Inc.'s balance sheet this is known as common stock. The share premium account is the account to which the amount of money that the shareholder paid in excess of a share's par goes. This share premium account is also known as "other paid-in capital" on Merck's balance sheet.

C)

Companies pay dividends on their common or ordinary shares in order to attract potential investors and to make stock price less volatile in bear, or down, markets. Paying dividends is one of several options for companies to do with their profits to reward their shareholders, themselves included.

Following a dividend payment, a company's share price generally drops. This is because two main reasons. The market value of a stock is the present value of all future sums; therefore, lacking one less future sum, the stock's present value slightly falls. Additionally, the demand for a stock will slightly fall due to the new, longer time that an investor must wait before he receives his investment.

D)

Companies may repurchase their own shares as a strategy to accomplish several things. Voting rights are retained when the controllers have a higher percentage of their shares. Having less shares outstanding also increases demand for the current shares outstanding, being that there are less supply. Manipulating investor confidence, the company can increase earnings per share because its denominator, shares outstanding, shrinks and it appears that the EPS is higher. Furthermore, a company may even repurchase its shares to "privatize" and avoid an external takeaway.

E)

12/31/07	Dividends Declared	$3,310,700,000	
	Cash		$3,307,300,000
	Dividends Payable		$3,400,000

F)

i.

12/31/07	Dividends Distributable	$2,793,000,000	
	Cash		$2,793,000,000

ii. Considering the last two interims of 2006 and the first two interims of 2007, $2,793,000,000 is the addition. This number is comparatively less that the $2,905,000,000 given by 2007 in note 15. The difference is what they have paid in 2007, and what they owe for 2007. The payment date for each dividend explains the difference, because this particular company pays after declaration.

G)

i. Merck uses the cost method to account for its treasury stock transaction. In this cost method Merck employed, they debited the treasury stock account for the reacquisition cost and deducted this amount from the paid-in capital and retained earnings on the balance sheet.

ii. During 2007, on the open market, Merck repurchased 26,500,000 shares.

iii. In 2007, Merck paid to buy back its stock $1,429,700,000 in total. Per share they paid $53.95. This is a financing activity listed on the Statement of Cash Flows as the line item "Purchases of treasury stock."

iv. Merck does not display its treasury stock as an asset for the reason that no one does: Treasury stock is not an asset. When a company purchases treasury stock, a reduction occurs in both assets and equity. It would not be appropriate to imply that a corporation can own part of itself. It is essentially the same as unissued capital stock, which cannot be advocated to be an asset.

H)

i. During 2007, GSK repurchased 285,034,000 shares on the open market. Of these repurchased treasury shares, 269 million were held in the treasury stock contra-equity account and 16 million were retired, or cancelled, permanently.

ii. GSK paid on average for each share 13.09 pounds when you exclude commission and stamp duty. As a whole, spending 3.8 billion pounds on 285,024,000 shares, GSK averaged spending 13.33 pounds to repurchase each stock.

iii. The comparable financial statement to note 34 Movements in equity required under U.S. GAAP is called Statement of stockholders' equity. A single journal entry that summarizes GSK's share repurchases in 2007 is posted below.

12/31/07	Retained Earnings	$3,800,000,000	
	Cash		$3,800,000,000

In U.S GAAP journalizing GSK's repurchase, an accountant would debit the treasury stock account, increasing the contra-asset, and credit the cash for the purchase. This differs from the way of above through IFRS where the retained earnings account was debited, and decreased.

I)

	Merck ($)	Merck ($)	Glaxo (£)
	2007	2006	2007
Dividends paid	3,307,300,000	3,322,600	2,793,000,000
Shares outstanding	2,172,502,884	2,167,785,445	5,373,863,962
Net income	3,275,400,000	4,433,800,000	5,072,926,636
Total asset	48,350,700,000	44,569,800,000	31,003,000,000
Operating cash flows	6,999,200,000	6,765,200,000	6,161,000,000
Year-end stock price	$57.61	$41.94	$97.39

**Net Income for GSK was calculated by taking the EPS and multiplying that by the shares outstanding for 2007 (94.4 pence multiplied by $5.3 billion pounds)

	Merck ($)	Merck ($)	Glaxo (£)
Year	2007	2006	2007
Dividends per share	$1.52	$1.53	$.52
Dividend yield	2.64%	3.65%	0.53%
Dividend payout	1.0097	0.7494	0.5506
Dividend to total assets	0.07	0.07	0.09
Dividends to operating cash flows	0.47	0.49	0.4533

What differences do you observe in Merck's dividend-related ratios across the two years?

By commenting on the comparison, the reader can better understand this data and interpret it into the rich information that the above charts and ratios offer. Between Merck's 2006 and 2007 years, one can note that the company had no drastic change in business model concerning their strategy with dividends. Practically, they kept their dividend to total asset ratio and their dividends per share ratio about the same between the two years. In 2006, when the net income was higher, Merck paid more dividends. When net income dropped in 2007, the controllers declared a lesser amount, but it was proportionately similar to the dividends per share and the dividends to total assets. Their rising stock market price did not affect the amount of dividend they paid out; therefore, their yield fell from 3.65 to 2.64%. As controllers, operating by these proportions is a part of their business model aimed at increasing shareholder value. Their complex strategy plays a role in these payout decisions.

What difference do you observe in the two companies' dividend-related ratios?

Merck and GlaxoSmithKline had a different strategy in regards to dividend issuance, and their ratios reflect it. These strategies hold a variety of different influencing factors such as the stark difference in asset valuation between the two companies as well as the difference in net income earned. (The reader must mind that, although the two are in different currencies, these ratios nullify that discrepancy because they are ratios and not amounts.) GSK has a lower dividend per share ratio, almost half of that of the same year in Merck's company. This is due to their lower dividends paid and their higher market value stock price (almost double that of Merck at $97.39 in 2007.)

Despite differing ratios in that regard, GSK likely has a similar business plan to Merck concerning their similar dividends to total asset ratios, where Merck's is $0.07 and GSK's is £0.09. Companies use this ratio as a measure of how notable their dividend amount and their asset liquidity are; these companies pay very similar proportions. A big difference in ratio that is largely influenced by the aforementioned companies' stock prices is the dividend yield, being that GSK's is about 20% of Merck's. However, the most substantial difference between the two companies is the dividend payout. Merck paid out twice as much in ratio as GSK in 2007. This indicates that GSK is retaining more of their earnings, leading to many hypotheses about the company's future plans (e.g. what do they intend to do with their increased equity through R/E). Because GSK's share value is already so high above par value, the lack of need to entice external buyers with high dividends is likely a factor in keeping that payout ratio lower than other companies.

CASE 10: INVESTMENTS
State Street Corporation
March 2, 2016

A.

i. Trading securities refer to debt or equity investments that a company holds with the intention of selling them in a short period of time in order to generate profits from short-term differences in price. Generally, companies hold these securities for less than three months.

Companies report trading securities at fair value. The unrealized holding gains and losses will be reported as part of net income.

ii. A company would record $1.00 of dividends or interest received from trading securities by debiting cash and crediting interest revenue or dividends.

iii. If the market value of trading securities increased by $1.00 during the reporting period, the company's journal entry would debit fair value adjustment (available-for-sale) and credit unrealized holding gain because the fair value is higher than the carrying amount (amortized cost) of the debt at the end of the reporting period. This shows an unrealized holding gain on the other comprehensive income, which will increase the OCI section of the company's income statement.

B.

i. Available-for-sale securities are debt or equity investments that the holding company plans on selling before their maturity or before a lengthy amount of time if the security is an equity item. Like trading securities, AFS securities are recorded at fair value with the difference as a gain or loss in the accumulated other comprehensive income account of the balance sheet's equity section.

ii. A company would record $1.00 of dividends or interest received from securities available-for-sale by debiting the cash dividend or interest and crediting the dividend or interest revenue.

iii. If the market value of available-for-sale securities increased by $1.00 then the company would recognize the gain and report it as other comprehensive income. The entry would be a fair value adjustment as a debit and an unrealized holding gain as a credit.

C.

i. Securities held-to-maturity are only long-term debt securities that a company holds with positive intent and with the ability to hold it until it matures. Equity securities are never classified as held-to-maturity because they don't have a maturity date and are an indefinite part of the company capital.

ii. If the market value of securities held-to-maturity increased by $1.00 during the reporting period, the company would not record a journal entry because they are not adjusted to fair value since selling price is irrelevant, given the owner's intent.

D.

i. The balance in the "Trading account assets" account on State Street's balance sheet on December 31, 2012 is $637 million, recorded at the market value.

ii. To adjust "Trading account assets" to market value from $552 million, a company would debit "Trading securities" for $85 million and credit unrealized gain on trading securities.

Trading securities	$85,000,000	
Unrealized Gain on Trading Securities		$85,000,000

E.

i. The 2012 year-end balance in the investment securities held-to-maturity account is $11,370,000.

ii. The market value of State Street's investment securities held-to-maturity is $11,661,000.

iii. The amortized cost of these securities is $11,379,000. Amortized cost represents the carrying value of the security with amortization factored in. Amortized cost is less or more than the original cost of the security depending on whether it had a discount or premium attached to it; over time, the amortization of the contra-account will affect the overall price.

iv. The difference between the market value and the amortized cost is that the market value is the fair value that the market demands for the security, where the amortized cost is the carrying value of the security that may have a discrepancy with the market.

The difference shows that the market value is $289 million higher than the amortized cost of the debt. This shows that the interest rate has fallen on the market because the fair value of the debt has risen. We know this because, say, the face rate is 8% and the market rate is 8%, causing a bond to be priced at $1,000 on the market on day, but, if the market rate falls to 6%, the debt's higher face rate will be more demanded and the debt's value will increase. We saw this happen with the higher price of State Street's debt. Looking closer, between the two years, the relative value of fair value over amortized cost grew between 2011 and 2012, affirming that the market rate fell over the time period.

F.

i. The 2012 year-end balance in the investment securities available-for-sale account is the fair value $109,682,000.

ii. The amount of net *unrealized* gains from securities available-for-sale held by State Street at December 31, 2012 is $1,119 million. We can calculate by looking at the table on page 115 of the case that presents the amortized cost and fair value, and their associated unrealized gains and losses, of investment securities. In 2012, for available-for-sale securities there is a $2,001 unrealized gain and a $882 unrealized loss. Net, we have a $1,119 million unrealized gain in 2012.

iii. The amount of net *realized* gains in 2012 from sales of available-for-sale securities held by State Street at 2012 year-end is $55 million, as shown as the differences between realized gains (losses) of $101 ($45) from the table of page 119.

The effect of this realized gain in 2012 of $55 million would be reported in the "Other expenses and losses" section of the income statement and would result in a reduction in net income. In this case, there would be a $23 million net gain listed.

G.

i. The journal entry State Street made to record the purchase of available-for-sale securities in 2012 is a debit to equity investment for $60,812 and a credit to cash for $60,812.

Equity Investment	$60,812	
Cash		$60,812

ii. The journal entry State Street made to record the sale of available-for-sale securities in 2012 is a debit to cash for $5,332 million, debit to unrealized holding gains of $67,000 in the account from 2011, and a credit to the investments account for $5,399 million.

Cash	$5,332,000	
Unrealized Holding Gains	$67,000	
Investments		$5,399,000

iii. By the information in G.ii., we can determine that the book value of the AFS securities sold were $5,332 million.

iv. To determine the amount of net unrealized gains and losses during 2012 for the available-for-sale securities on hand at December 31, 2012, one needs to use a T-account. First, debit and remove the recorded net unrealized gains from 2011, $67 million. This is associated with a reversing entry that gets rid of the unrealized gains from the prior year. Then, we are given the ending balance in the balance sheet ending balance of 2012 as $109,782,000, a $9,850,000 increase from the prior year. With the prior gain written off, there will be a total increase in the securities' fair value of $9,782,000.

CASE 11: REVENUE RECOGNITION
Groupon
March 25, 2016

1. Compare and contrast the business model of Groupon with the business models of Amazon and Wal-Mart. Referring to the risk factors in the MD&A sections of their 10-Ks, compare significant risks and opportunities across these companies. How do these business risks translate to risks in financial reporting?

There are many similarities and discrepancies between the business models of Groupon and those of Amazon.com and Wal-Mart. The similar success of these companies stem largely from the similarities in their business model and vision. The two businesses are experts at channeling the Internet's relative convenience for its massive base of customers into profits away from the retail store of the 1990's and prior. While the companies have similar business model motives, they, for the most part, make their money in different methods. Groupon has customers pay up front for a voucher pertaining to a certain product and, with leverage, buys for a group with a discount. Amazon.com either owns the product that they sell, of which they bought at a discount themselves then sold to the customer, or they act as a middleman between a third party for single product sales, taking a sales commission fee for the individual sale. In this process several similarities and differences are apparent between the way the two businesses make the actual sale and record the direct revenue.

Furthermore, there is a great similarity between the marketing outlook and vision concerning the customer in mind between Groupon and Wal-Mart. Groupon has a very generous right of return, featured prominently on the company's website, guaranteeing the quality of services/goods on behalf of the vendor and "cash-back" from Groupon if they should be dissatisfied. In Wal-Mart, any product can be returned at anytime, even if it has been used, no questions asked. "The Groupon Promise" that states "If Groupon ever lets you down, we will return your purchase—simple as that" even sounds quite like Wal-Mart's simpler "Satisfaction Guaranteed."

Stark differences consist between their customer payment method mentioned two paragraphs above as well as their long-term strategy regarding the global market. In Amazon.com's M.D. & A section of their 10K, their management discusses extensively the disadvantage that currency fluctuation and exchange rate has on their domestic market consolidated trends and stateside financial reported results. The risk of currency volatility requires the constant evaluation of relative reporting with the U.S. Dollar relative value in mind. Factor's such as these drive Amazon.com's policy that diversification beyond the U.S. benefit their shareholders over the long-term.

Unlike Amazon, Groupon has focuses on building their company domestically, citing the high cost of localizing, different burden's of foreign government regulation, and much of their newly implemented technology is accessible in EMEA countries but has not been developed elsewhere in the world. Because of this, Groupon's revenue internationally has consistently decreased as a percentage of their net revenue.

2. ‘‘Revenue and revenue growth are more important than income and income growth for new businesses, especially in the new-age economy.’’ Do you agree with this statement? Support your opinion by analyzing the relationship between Amazon’s revenue, income, and its stock price from 1997 to 2010.

Revenue and revenue growth are indeed more important than income and income growth for new businesses. As a company starts up and is amidst the intro and growth stage of its life cycle, analysts expect to see a net loss. The company is young, taking on great debt and paying notes, building facilities, and marketing, and the sales and popularity have simply not come yet.

Below is a chart showing the relationship between revenue and stock price and income and stock price. By looking at the empirical evidence, it is clear that the revenue drives stock price while the income loss has no apparent loss on the stock price growth trend.

(Amended S-1)		Amazon.com (dollars $)			
	Year	1997	2001	2005	2010
Revenue		147.8 m	3.12 B	8.49 B	34.2 B
Income (loss)		(27.6 m)	(546.2 m)	333 m	1.15 B
Stock Price		5.00	10.90	50.00	180.00

3. Using the data provided in Table 1, prepare common size income statements using revenues and cost-of-goods-sold in the original S-1 and amended S-1. Analyze trends of expenses as a percentage of revenue for 2009 and 2010. Compare and contrast the following ratios:
a. Gross Margin Percentage;
b. Asset Turnover Ratio.

The Gross Margin is a percentage of profit that the company retains after incurring direct costs associated with producing goods. GM is calculated by subtracting cost of goods sold from revenue, then dividing by that revenue. The Asset Turnover Ratio is sales divided by total assets; it is a measure of a company’s ability to use assets to generate sales.

Here are the numbers that we will analyze. In 2009, the amended S-1 Gross Margin was 69.66%. Later in 2010, the amended S-1 GM was 89.61%. This shows that Groupon, as it grew, became more efficient at retaining their profits. Largely, the company’s positive result is an effect of Eric Lefkofsky’s ambitious plan to push for a massive increase in sales. These sales increase so much, while the expenses stay much the same, resulting in a better Gross Margin. With sales companies like these, such strategy is often an effective way to increase GM.

In 2009, the amended S-1 Asset Turnover Ratio was .96, and in 2010 the amended S-1 Asset Turnover Ratio was lower, at .82. These numbers resulted from the company increasing their assets at a massive rate; higher than that of the increase in sales. Though this is a negative effect on the Asset T.O. Ratio, an analyst can see decipher this down number. It is a result of the company generating almost 360 million dollars in assets in a year, not becoming more inefficient in generating sales from its assets.

TABLE 2

Groupon Selected Disclosures
Balance Sheet Excerpts (in '000s)

	December 31	
	2009	**2010**
Assets		
Current assets:		
Cash and cash equivalents	$12,313	$118,833
Accounts receivable, net	601	42,407
Prepaid expenses and other current assets	1,293	12,615
Total current assets	14,207	173,855
Property and equipment, net	274	16,490
Goodwill	—	132,038
Intangible assets, net	239	40,775
Deferred income taxes, non-current	—	14,544
Other non-current assets	242	3,868
Total Assets	$14,962	$381,570

Footnote Disclosure of Accounts Receivable, net:
Accounts receivable primarily represent the net cash due from the company's credit card and other payment processors for cleared transactions. The carrying amount of the company's receivables is reduced by an allowance for doubtful accounts that reflects management's best estimate of amounts that will not be collected. The allowance is based on historical loss experience and any specific risks identified in collection matters. Accounts receivable are charged off against the allowance for doubtful accounts when it is determined that the receivable is uncollectible. The company's allowance for doubtful accounts at December 31, 2009, and 2010 was $0 and less than $0.1 million, respectively. The corresponding bad debt expense for the years ended December 31, 2008, 2009, and 2010 was $0, $0, and less than $0.1 million, respectively (Groupon 2011a, F-9).

TABLE 1

Abridged Income Statements for Groupon

	2009		2010	
Income Statement Account	**Gross**	**Net**	**Gross**	**Net**
Revenue	$30.4 M	$14.5 M	$713.4 M	$312.9 M
Cost of Sales	19.5 M	4.4 M	433.4 M	32.5 M
Gross Margin	10.9 M	10.1 M	280.0 M	280.4 M
Marketing Expense	4.6 M	4.9 M	263.2 M	284.3 M
General and Admin. Expense	7.5 M	6.4 M	233.9 M	213.3 M
Other Expenses			203.2 M	203.2 M
Net Loss	1.34 M	1.09 M	413.4 M	420.1 M
Net Loss to common shareholders	6.92 M	6.92 M	456.3 M	456.3 M
EPS (Basic)	(0.04)	(0.04)	(2.66)	(2.66)

This information was obtained from Groupon's S-1 filing with the SEC on June 2, 2011, and the amended filing (Amendment No. 4) on October 7, 2011.

4. In the months leading up to Groupon's IPO, the SEC posed a number of questions regarding Groupon's choice of accounting principles for revenue recognition. Specifically, the SEC referred to the requirements in FASB's ASC 605-45-45.

a. Compare the amount of revenue reported in the original and amended S-1s. What caused the difference?

In 2009, the gross revenue was 30.4 million but the net was 14.5 million. This discrepancy was due to the change in revenue recognition that the SEC implemented for Groupon to report. Using the gross method in the original S-1, Groupon was recognizing for the entire purchase between the customer and the primary obligor as revenue, when they really should have been only recording their sales commission.

b. Which of the two amounts do you think Groupon preferred? Why did they prefer it?

Groupon would have very clearly preferred the Gross Method, that which they were trying to advance prior to SEC regulation. This is because of my point in number 1. High revenue is very enticing to stock holders, whether deserving or not, and high growth attracts investors and company confidence.

Furthermore, the gross method has a higher cost of goods sold. This is great for tax purposes, enabling the company to report a lower income.

c. In correspondence with the SEC following its initial S-1 filing, how did Groupon justify its method of reporting revenue?

In the correspondence, Groupon justified their method of reporting revenue by describing itself as indeed the primary obligor, holding the risk articulated by the "Groupon Promise" it held while the customer's product was in transit.

d. With reference to ASC 605-45-45, which of Groupon's arguments were weak, and why?

Groupon's argument regarding its use of gross method is weak because, if the company were the primary obligor, it would not have been appropriate for the company to recognize revenue prior to delivery of the underlying product by the merchant to the customer, which it did.

5. Groupon had recognized revenue for the sale of high-ticket items in late 2011. Purchasers of the Groupon product have a right of return, as specified in the ''Groupon Promise,'' prominently featured on its website.

e. Assess the U.S. GAAP requirement for recognition of revenue when right of return exists, specified in ASC Section 605-15-25, in the context of Groupon's business model.

WFASB concludes that if a company sells its product but gives the buyer the right to return it, the company should recognize revenue from the sales transactions at the time of sale only if all of six conditions are met. They include if the seller's price to buyer is substantially fixed at date of sale, the buyer is obligated to pay the seller, the buyer's obligation to seller won't change in damage or theft, the buyer acquires the product for resale has economic substance apart from that provided by seller, the seller does not have significant obligations for future performance to bring resale of the product, the seller can reasonably estimate the amount of returns.

If the six conditions are not met, here is the FASB standard. The company either recognizes sales revenue and cost of sales when the return privilege has substantially expired or when the six conditions are met, whichever comes first.

f. Do you agree with Groupon's accounting? Why or why not?

I agree with Groupon's accounting because it is not insubordinate to FASB rules; instead, it does follow the rules listed above. In just a several years, they will have a better way from experience to estimate reasonably the returned items, making more accurate the revenue recognition. Causing them to delay their recognition to after the customer's period of return expires seems unnecessary.

g. What could Groupon have done differently, and how would the financial statements have been affected?

Groupon could have differently recorded their sales with a lenient estimate of returns against their sales revenue recognition. To regulators, they would seem much less conspicuous, enacting a sort of penalty on themselves against their originally high revenue and thus avoiding having to use their new net revenue.

6. Groupon's restatement of 2011 fourth-quarter financials resulted in a reduction of $14.3 million of revenues and a decrease of $30 million of operating income. However, its operating cash flow was unaffected. Explain how this is possible.

This is possible because operating cash flows are influenced by the incoming cash that the company records the incoming cash immediately, but the income is low because the company cannot record the sales until after the period of return ends. Especially, this circumstance occurred because of the amount of deferred revenues and the capitalized market costs. These accounts have this affect on operating cash flows, where they can affect the statement of cash flows and not necessarily the income statement.

CASE 12: DEFERRED INCOME TAXES
ZAGG Inc.
April 13, 2016

A. Taxable and book income differ in meaning and use. Book income is in the income before provision that the firm marks as a sort of income before taxes. It is a term used for financial reporting purposes. Taxable income is a tax accounting term that indicates the amounts used to compute the income tax. Taxable is drastically different enough to be coined a different term than book because it takes into account the provisions for the differed tax assets, tax liabilities, and many permanent and temporary differences.

a. Zagg Inc.'s income before provision line item statement prepares the statement for the 'provision' that fixes the aggregate of all different deferred tax liabilities and assets.

B.

a. Permanent tax differences result when there are items that enter into book income, also known as pretax financial income, but never into taxable income, or into taxable income, but never into book income. Once this occurs, there results in a permanent difference.

b. Temporary tax differences are items that result in taxable amounts in future years when the revenue is recovered.

c. Statutory tax rates are the legally imposed tax rates, be it by the federal government or state.

d. Effective tax rates are the income tax expense divided by the total income. More specifically, it is the average rate at which their income is taxed. Therefore, it is more accurate after taking into consideration and calculation the many different factors, like deferral and depreciation that a firm pays above or below the cut and dry statutory tax rate.

C.

a. Deferred Tax Liability represents the increases in taxes payable in future years as the result of taxable temporary differences existing at the end of the current year. A deferred tax asset represents the increases in differed taxes refundable in future years as the result of the deductible temporary differences at the end of a current year.

b. A situation that would give rise to a deferred tax liability on a balance sheet would be installment sales. This is because as you receive the cash in future years you will be forced to pay those deferred tax liabilities.

c. A situation that would give rise to a deferred tax asset would be warranty expense because the expense deducts taxable income and the tax asset that is the slight decrease in tax because of the lessened taxable income from the expense.

D. A deferred income tax valuation allowance is a balance sheet line item for deferred tax assets and is created for when the company has a 50 percent probability or more (more likely than not) that they won't realize some of the portion of deferred tax assets. It should be recorded soonest to when it is realized for the sake of conservatism for users and for good faith on the books.

E.

a. 2012 Provision Journal Entry
 i. Income Tax Expense 17,686
 ii. Deferred Tax Asset 8,293
 1. Income Tax Payable 25,979

b. First, the regular income tax expense is debited because it is expensed for this period and has no effective use in later periods. The deferred tax assets, on the other hand, is being debited because it has been held on the balance sheet until now to be payable in this current period.

c. The difference between statutory and effective rates are the different provisions which include the deferred tax assets and deferred tax liabilities included into the effective tax rate. Meanwhile, the statutory rate is more of a flat, government imposed rate. The calculated effective rate is the provision paid out (9,393 in thousands) divided by income before that provision for taxes (23,898 in thousands). This equals 39.3 percent.

d. The net deferred tax asset shows up on the balance sheet under the noncurrent assets.

F.

a. The tax system will create a higher depreciation expense because they used accelerated depreciation and, because of the nature of that system of depreciation, expense will be accrued at a slightly higher rate over time, which in thousands is 794.

b. The cumulative difference in book and tax depreciation expense is 2,089.47 (in thousands). That number, multiplied by the total statutory income tax rate of 38 percent, is 794 (in thousands), which is presented on the Balance sheet as a difference.

c. Had tax depreciation been used throughout the asset's lives instead of by the reported method, the balance sheet of December 31, 2012 would have read a number much lower. This is because there would not have been the discrepancy between book and taxable income and therefore less cumulative difference.

G.

a. During the year ended December 31, 2012, the tax system recognized a greater expense for doubtful accounts. I see this when we see on Note 8 that the taxes' allowance for doubtful accounts increases from 791 in 2011 to 1020 in 2012.

b. In the current period, the difference in book and tax bad debt expense in 2012 was 602 million dollars. With the statutory rate being the combined state and federal rate of 38 percent, the change in the deferred income tax asset relating to the allowance for doubtful accounts was 229.

H. Zagg Inc. determined that a valuation account was necessary because it was more likely than not that they would not realize a portion of it. The amount of deferred income tax asset valuation allowance at December 31, 2012 was negative of 713 million dollars.

I. The total of 17,358 rounded dollars in thousands got taxed to a deferred income tax assets line item of 6,596 with the 38 percent tax rate. Once the statutory tax rate changed from 35 percent to 30 percent federally, the aggregate of state and federal tax equaled 33 percent and we calculate the new deferred tax asset line item to be 5,728 dollars in thousands. The journal entry for changing the provision is as such.

Income Tax Expense	868	
Deferred Tax Asset		868

With this journal entry the deferred tax asset is written off of the books as a tax expense and the allowance valuation account is effectively changed.

CASE 13: RETIRMENT OBLIGATIONS
Johnson & Johnson
April 20th, 2016

A.

a. The defined contribution plan is where the employer agrees to contribute to a pension trust a certain sum each period, based on a formula. This is often a 401(k) plan.

The defined benefit plan differs from the defined contribution plan in that it does not contribute a certain sum each period but instead guarantees the benefit the employee receives upon retirement. Thus, the two plans differ in timing in how the companies pay employee benefit.

Johnson & Johnson actually sponsor various retirement and pension plans, including defined benefit, defined contribution and termination indemnity plans. Overall, the Company generally uses the defined contribution plan, stating that they have the right to modify these plans in the future, as opposed to being obligated to award the employee each period a defined plan amount.

b. Retirement plan obligations are liabilities because they represent the obligation of payment that the company owes.

c. Actuaries must make many predictions, or actuarial assumptions, of mortality rates, employee turnover, interest and earnings rates, and many other factors necessary to operate a pension plan.

B.

a. The companies pension obligations are influenced each year by four main types of activities: service cost; interest cost; actuarial gains or losses; and benefits paid to retirees. Service cost is the actuarial present value of benefits attributed by the pension benefit formula to employee service during a period. This service cost is what an employer must pay's present value to obtain the employee's guaranteed future benefit.

Interest cost is the interest for the period of the projected benefit obligation outstanding during the period.

Actuarial gains or losses are the actual return on the plan assets and the increase in pension funds from interest, dividends, and realized and unrealized changes in the fair value of the plan assets. If the actual return is positive, then the company subtracts it when computing pension expense. If negative, the company adds it when computing pension expense.

Benefits paid to retirees are the payout that the employer makes to its retirees. It decreases plan assets.

C.

a. The companies' pension assets are influenced each year by three main types of activities including actual return on pension investments, company contributions to the plan, and benefits paid to retirees. Actual return on pension investments are different from expected return on pension investments because they are not solely an estimate but instead that which was actually recorded.

D. In general, companies' pension expense and pension plan assets both have a return on plan assets component; however, they differ in that the return for the pension expense is the expected return and the return for the plan assets is the actual return.

The rationale for this difference is that because plan asset's actual return are reported at fair value and the net of the beginning and ending balances of fair values because it is important to take fair market value into the plan asset total.

E. The primary difference between the company's other-benefits plan and its retirement plan is that the retiree health benefits are not funded in advance while the retirement plan is funded with compensation from the years prior.

F.

a. Johnson & Johnson incurred 646,000,000 in 2007.

b.

Service Cost	597			
Liability		587		
	Interest Expense		656	
		Liability		656

G.

a. At December 31, 2007, the company's retirement plan obligation is $12,002,000,000. This value represents the obligation that they owe to pay their employees at retirement.

b. The pension related interest cost for the year 656,000,000 and the average interest rate the company used to calculate interest cost during 2007 is 5.63 percent. This interest rate seems to be a little higher than the average in that year, which was around 4.9 percent or 5.0 percent. The interest rate that the company uses is adapted and compared to interest rates on great investments; therefore, the resemblance is adequate.

c. $481,000,000 was paid out in pension benefits to retirees during the 2007 fiscal year. Johnson and Johnson did pay cash for the benefits since it was out of their plan assets. The benefits paid out are a deduction from the plan assets and decreases the obligation plan assets.

H.

a. The value at December 31, 2007, of the retirement plan assets held by Johnson & Johnson's retirement plan is $10,469,000,000. This value is the fair value of the company's investments.

b. In 2007, the expected return on plan assets in is 809,000,000 while the actual was 743,000,000. In 2006, the expected return on plan assets was 701,000,000 and the actual return was greater at 966,000,000. These differences are significant. The 2006 return better reflects the economics of Johnson & Johnson's pension expense because not only did they meet their expected return but they exceeded it, favorably increases the company's plan assets.

c. Johnson & Johnson and their employees contributed to the retirement plan, during 2007, 317,000,000, while in 2006 they contributed 259,000,000. This reflects the difference in the company's contributions.

d. Johnson & Johnson's retirement plan assets are comprised of investments including equity securities, debt securities, and even a small portion in real estate. Largely equity securities are hold the biggest proportion of investments in 2007 at 79 percent domestically and 67 percent internationally.

I. We know that a company is in overfunded or underfunded status by measuring the difference between fair value of the plan assets and the projected benefit obligation. At

December 31, 2007, the company's retirement plan was underfunded because the PBO numbered $12,002,000,000 and more than the plan assets at fair value at $10,469,000,000. In 2006 at year-end, the pension is underfunded as well because PBO is 2,122,000,000 more than plan assets.